Box 5.2

Developments Regarding the CBRT's International Reserves

The Central Bank of the Republic of Turkey (CBRT) compiles and publishes data and statistics on issues that fall within its area of responsibility in a timely, comprehensive and transparent manner consistent with international standards.

In this respect, the CBRT is one of the few central banks that publish their balance sheets on a daily basis, and its activities can be followed daily via the "Analytical Balance Sheet". On the other hand, regarding the reserves data, in addition to weekly data release intended to provide the public with timely information, the International Reserves and Foreign Currency Liquidity Table[1] that member countries are liable to report within the framework of the Special Data Dissemination Standards (SDDS) set by the International Monetary Fund (IMF) is also published on the CBRT website on a monthly basis. This table is also reported to relevant institutions as the detailed main statistics that allows for cross-country comparison. In this way, data regarding the changes in reserves can be closely monitored by the markets.

International Reserves and Reserve Adequacy

The concepts of gross and net international reserves have recently become a topical issue due to discrepancies in all these disclosed data driven by different publication times and contents. While international reserves have a generally accepted definition as gold and foreign currency-denominated assets that are readily available to and controlled by monetary authorities, there is no such an internationally accepted definition for the "net reserve" concept since different liability items or expected foreign exchange outflows from these reserves are not standardized.

Therefore, "reserve adequacy" indicators measuring the short-term external liability coverage capacity of reserves are defined based on gross international reserves rather than net reserves. As external financing need also declines even when banks use their FX reserves held at the Central Bank for their potential FX payments (such as paying down external liabilities or covering deposit withdrawals), the entirety of gross reserves including banks' reserves held at the Central Bank is taken into account in reserve measurement indicators. Considering that traditional reserve indicators focus only on a single aspect of potential sources of risks and often fail to compare the reserve levels of countries with structural differences, the IMF has developed, after a series of empirical and scenario analyses, a new reserve adequacy metric for developing countries, which also takes into account the exchange rate regime implemented by those countries.[2] This method introduces a comprehensive perspective that also takes the structural fundamentals of the countries into account. Another important issue regarding reserve measurement is that not only official reserves but also external foreign exchange deposits of the banking system and corporates should be taken into consideration in discussions about the adequacy of reserve assets held against the external liabilities of a country.

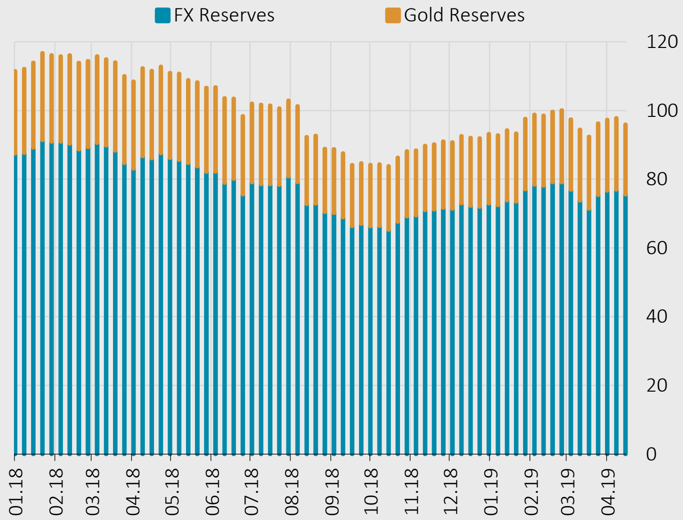
[1] Developed in collaboration with the IMF, the Bank for International Settlements (BIS) and the European Central Bank (ECB).

[2] For detailed information, see Assessing Reserve Adequacy – Specific Proposals (2015), IMF Policy Papers, Assessing Reserve Adequacy – Further Considerations (2013), IMF Policy Papers, Assessing Reserve Adequacy (2011), IMF Policy Papers.

Factors Leading to Changes in International Reserves

Under the international reserves management policy, the CBRT's primary objective is to strengthen and efficiently manage its international reserves. However, short-term fluctuations may be observed in reserves data due to monetary and exchange rate policy implementations shaped by domestic and foreign economic and financial conditions as well as due to conjunctural developments (Chart 1). In this context, foreign exchange liquidity transfers to/withdrawals from the banking sector via changes in foreign exchange (FX) and Turkish lira (TL) reserve requirements ratios, changes in banks' free FX reserves held in the CBRT accounts, FX sales to energy-importing state-owned enterprises, external debt and other FX transactions executed on behalf of the Republic of Turkey Ministry of Treasury and Finance, FX borrowings of the Ministry in Turkey and abroad, and foreign exchange reimbursement of export rediscount credits are listed among the main items affecting the international reserves. For instance, in the third quarter of 2018, there was a gradual downward trend in the CBRT reserves mainly due to the reductions in TL and FX reserve requirement ratios. Meanwhile, although the export rediscount credits are recorded on the CBRT's balance sheet in Turkish lira terms, their reimbursement made in foreign exchange stands out as a policy instrument that regularly increases the CBRT reserves in the medium/long term. Considering the credits extended until 19 April 2019, the export rediscount credits to be reimbursed in the rest of 2019 are expected to increase the foreign exchange reserves by approximately 14.1 billion US dollars.

Chart 1: CBRT International Reserves (Billion US Dollars)



Source: CBRT. Last Observation: 19 April 2019

Complementary policy instruments used by the CBRT to enhance the effectiveness of TL and FX liquidity management may also indirectly affect its international reserves. Accordingly, FX transfers arising from banks' use of the CBRT facilities such as FX Deposits Against TL Deposits Auctions, FX collateral deposits, TL Currency Swap Market and Reserve Options Mechanism on their own initiative depending on the financial market conditions may lead to periodic fluctuations in reserves. As a matter of fact, recent domestic and international market developments have led to a more active use of the CBRT's TL Currency Swap facility, and these swap transactions have recently become the main item affecting the CBRT reserves.

Through the TL Currency Swap facility initiated in November 2018, the CBRT engages in swap transactions with the domestic banks where the CBRT receives FX and provides TL in the spot leg. At the maturity of these swap transactions, the banks make their repayments to the CBRT in TL at the forward exchange rate agreed on the transaction date (which nets the Turkish lira and US dollar legs' yields), and the CBRT transfers the amount of foreign currency received on the transaction date back to the banks. Swap transactions are recognized in accordance with international accounting standards.

In the banking sector, foreign currency liabilities account for a large share on banks' balance sheets due to the typical inclination of households and firms for FX deposits, as opposed to loans which are predominantly denominated in Turkish lira and account for a significant portion of assets. This leads to an FX short position on banks' balance sheets. As required by the banking regulation related to the exchange rate risk management and net FX position, banks offset their on-balance sheet FX short positions with swap, forward, option and other derivative transactions, of which the forward legs are recorded off-balance sheet. FX swaps come to the fore as the most frequently-used derivative instrument by the banks in this context. Considering that banks' need for swaps generally increases (decreases) during periods when residents' FX deposits increase (decrease), in particular, the swap facility provided by the CBRT can be said to act counter-cyclically. From this perspective, the CBRT's swap facility provides banks with flexibility in their TL and FX liquidity management, and serves as an additional facility for them. Additionally, interest rates applied in the CBRT's TL Currency Swap transactions act as a reference for offshore swap rates.

Factors such as liquidity positions, developments in market interest rates, risk premium and transaction costs affect the banks' use of the CBRT's swap facility, which can also cause fluctuations in the CBRT reserves. In fact, as the offshore TL swap rates remained lower than the CBRT's policy rate from the launch of the facility in November 2018 until the last week of March 2019, the banks' utilization of the swap facility remained limited. However, following the depreciation of the TL in the last week of March 2019, short-term offshore swap rates tested historic highs as a consequence of a TL liquidity squeeze in offshore markets. So, in order to provide the banks with flexibility in their TL and FX liquidity management and to contribute to the normalization of offshore swap rates, the CBRT gradually increased the banks' transaction limits at the TL Currency Swap Market, which were initially limited to 10% of their transaction limit at the Foreign Exchange and Banknotes Markets, to 40%. Moreover, the CBRT suspended the FX Deposits Against TL Deposits Auctions on March 25, 2019, thereby bolstering the TL liquidity in the market through this channel. The high level of offshore TL swap rates and the imbalance between supply and demand have led to a significant increase in utilization rates of the CBRT's currency swap facility. The CBRT will maintain its TL Currency Swap facility also in the upcoming period to assist banks in their liquidity management.

Conclusion

Reserve adequacy indicators are defined based on gross reserves. Considering the typical inclination of households and corporates for FX deposits in the banking sector, it is necessary to take both official reserves and external foreign exchange deposits of the banking system and corporates into consideration when evaluating the adequacy of all reserve assets held against the external liabilities of a country. In addition, thanks to the promising trend in export and tourism revenues, the process of current account rebalancing is expected to trigger a significant improvement in reserve adequacy indicators. Although short-term fluctuations may be observed in reserves data due to monetary and exchange rate policy implementations and conjunctural developments, international reserves are expected to maintain their upward trend in the coming period.